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Via E-mail to regcomments@ncua.gov
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Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Advanced Notice of Proposed Rule Making for Part 708(a) and 708(b)

Dear Ms. Rupp:

Please consider this letter my comments with respect to the Advanced Notice of Proposed Rule Making for Part 708(a) and 708(b) (the "ANPR"). The representation of credit unions in the Mid-Atlantic region is a significant part of my practice, and I believe that the issues raised in the ANPR are important to my clients and the credit union industry as a whole. I would note that I have reviewed the letter dated March 31, 2008 from Styskal, Wiese & Melchione, L.L.P. and, except as noted herein, agree with many of the observations, recommendations and comments expressed in that letter.

Fiduciary Duties

It is appropriate for the NCUA to set forth and adopt standards for the conduct and specific duties and responsibilities of the boards of directors and officers of federally chartered credit unions. Such standards could also be required for federally insured, state chartered credit unions ("FICU"), as a condition of maintaining share insurance through the fund. The fundamental duties of care and loyalty which directors and officers of corporations owe to those entities is well established in most, if not all, jurisdictions. However, it would be helpful for the NCUA, within the regulations, to specifically provide that such duties are equally applicable to directors and officers of federally insured credit unions. This would assist state and federal courts in making the determination as to whether or not those duties are the same for directors and officers of federally insured credit unions.

In addition to setting forth the duties of due care and loyalty, any such regulations should provide that directors would have the protection of the Business Judgment Rule. I do not believe that it would serve the interests of credit unions to raise the level of the duties of directors and officers to the trustee standard. This standard is more appropriate in nonprofit organizations where the beneficiaries have little or no say in the election of directors and officers or otherwise lack control over the organization. In the case of federal credit unions, the members have the ability to elect directors and thus ultimately have control over the institution and who directs it. With some exceptions (which are largely due to an improper determination of which duty applied and to whom it was owed), these more traditional standards, which are generally applicable to corporations, have served to guide credit union directors and officers well in the history of the industry. These standards have allowed officers ad directors of credit unions to make business decisions which enable their credit unions to provide competitive services to their members without fear of second guessing by a third party. The imposition of a higher standard could thwart the ability of credit unions to remain competitive with other financial service providers.

Any new regulations should also contain a provision which specifies to whom the duty is owed. This is an issue which has arisen in several instances in recent years. A survey of the law of 50 states and the District of Columbia, with respect to the question of to whom the fiduciary duty of directors and officers is owed, reveals that, in the majority of states (38), the duty is owed to the corporation *and* its shareholders. In 18 of these states,[1] the applicable statutes provide that the duty is owed to the corporation without specifically mentioning the shareholders. However, the case law developed in those jurisdictions interprets those statutes to mean the duty is owed to the corporation *and* its shareholders. In 13 of these states,[2] the statutes were silent on the issue of to whom the duty was owed, or there was no statute specifically addressing the issue. However, the case law from those jurisdictions also held that the duty was owed to the corporation *and* its shareholders. In the other seven of those states,[3] the statutes specifically provided that the duty was owed to the corporation and its shareholders. Only 10 states[4] have statutes which provide that the duty is owed to the corporation and do not specifically mention or extend the duty to shareholders. In these states case law has developed interpreting their statutes as not expanding that duty to the shareholders. In the remaining two states, Hawaii and New Mexico, the law is unclear, as it is not addressed in either a statute or relevant case law. Indiana and Tennessee were the only states with a statute and/or case law that specifically addressed the issue for non-profit corporations, and Missouri and Washington are the only states which have specifically

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[1] Alabama, Alaska, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, North Dakota, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia and West Virginia

[2] Delaware, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, Oklahoma, Rhode Island and Wisconsin and the District of Columbia)

[3] Arizona, California, Idaho, Louisiana, Ohio, South Carolina and Wyoming

[4] Arkansas, Kentucky, Maine, Minnesota, Nevada, New York, North Carolina, Oregon, Pennsylvania and, arguably, Washington

addressed this issue for credit unions, with Missouri holding that the duty is owed to the shareholders and Washington holding that it is owed to the institution. There is thus a need for clarification on this issue which would bring the minority of states in line with the majority viewpoint that the duty is owed to the credit union ***and*** its members with regard to FICUs.

Non Credit Union Mergers

In the context of a merger of a FICU into a non credit union entity, the NCUA should consider requiring, as a condition to such a transaction, that an independent evaluation and/or fairness opinion be issued. This would serve the function of ensuring that an appropriate level of due diligence has been done by independent, qualified individuals, which will provide the board with proper guidance in making its decisions and fulfilling its fiduciary duties. One method of ensuring independence in such transactions is the use of a change of control board, which is noted in the comment letter submitted by Styskal, Wiese & Melchione, L.L.P. If properly structured and chosen, such a board would serve to ensure that the interests of the members are protected in such transactions. This would be preferable to delegating this responsibility to the supervisory committee of the credit union. At this point, many credit union supervisory committees are not properly equipped to fulfill such duties. The supervisory committees would be better able to act in such a capacity in the future, if the NCUA were to raise the requirements for service on the supervisory committee of a credit union to the level of expertise and experience in financial matters similar to that required of audit committees of publicly traded companies.

I would urge the NCUA to resist putting too many regulations in place to address such mergers, as the result could be encouragement of the transactions, as noted in the ANPR, or the thwarting of transactions which may otherwise be in the best interests of the members. It is important to note in this context, and in the context of mergers overall, that one of the unique characteristics of credit unions is that they are owned by the members. Part of this ownership is the right, should the members determine to do so (after receiving full disclosure and adequate information), to change their charter to a non credit union charter. Similarly, any requirement of a merger distribution would only serve to inhibit transactions which the majority of members have determined should go forward. If the majority of the members of the credit union determine to merge or change their charter, the decision to issue a merger dividend in conjunction with that transaction should be left to the board as part of the negotiation process. To ensure that the will of the majority controls such transactions, regulations could require a supermajority vote in any transaction which would result in a change of control. This type of requirement is often an effective protection for the shareholders of for-profit corporations.

One way to facilitate member participation in the ultimate conversions from an MSB to a stock bank would be to require, as a condition of the conversion of the credit union charter to an MSB, that each member be issued an appropriate number of warrants or pre-emptive rights for the stock of the stock bank in the event that the eventual conversion occurs. This would allow the members to freely trade the warrants or otherwise capitalize on their rights, should the MSB convert to a stock bank at a later date.

The practical effect of unduly restrictive regulations or the requirement of a merger distribution could be contrary to the basic premise of the credit union industry – that the institution is owned by the members, who direct the institution by majority vote. A foundation for that premise is that it is the will of the majority which should control the ultimate outcome of a transaction or decision.

Insider Enrichment

In considering unjust enrichment in the context of insider benefits resulting from such transactions, a regulation would be appropriate which requires a director, who may have an interest separate and apart from his or her interest as a member in any such transaction, to recuse him or herself from, not only the decision, but any deliberations on that decision. The use of an independent evaluation, change of control board or properly qualified supervisory committee as set forth above would serve to foster independence in these decisions and thereby limit the influence of personal benefit on the ultimate decisions.

Communications With Members

With respect to communications from credit union officials to members regarding conversion or merger transactions, the NCUA should look for guidance to securities laws which are applicable in most states. Generally, the use of a false or misleading statement in the context of an offering of what would be considered a security, whether publicly traded or privately held, would be considered a crime in most states, punishable in accordance with local securities laws, if not SEC regulations. The NCUA could adopt a similar standard for purposely misleading statements or any failure to include material information in disclosures in conjunction with a merger or conversion transaction. I do not believe it would be appropriate (or legally enforceable) for the NCUA to prohibit communications from third parties to credit union members regarding a merger or conversion, or any other transaction, so long as the communication is not misleading, and did not result from a disclosure of confidential information of the member to such third party.

Voting Procedures

The ANPR's suggestion of a recount provision in the event that evidence exists that the original vote tabulation was unreliable is recommended. Likewise, the NCUA should (i) prohibit the use of an interim vote tally; (ii) prohibit credit union management from obtaining, from the election teller, a list of members who have not voted ; (iii) prohibit credit union employees from soliciting credit union members to vote; and (iv) prohibit credit union employees from completing member ballots or otherwise handling ballots. These requirements will ensure the integrity of any voting process. I would further recommend that the regulation require the use of an independent teller of elections, such as AAA, and that the cost of such an election be disclosed in the disclosures to the members. The regulations should also provide for a record date for any transaction, which would prohibit members who have not joined by such date from voting on such transactions.

Finally, I would not recommend and would strongly urge the NCUA not to adopt any regulation which provides for an administrative review *to any extent*, of director and officer actions, unless they impact on the safety or soundness of the credit union. I do not believe the regional directors are qualified or trained to make determinations as to the nuances of director and officer fiduciary duties and/or the proper application of the Business Judgment Rule or merger issues, in general. Such a provision could result in the delay of otherwise valid transactions by disgruntled members who are on the minority side of a vote, or incessant second guessing of board and officer decisions, which could serve to paralyze directors and officers in exercising their duties. If the NCUA were to adopt regulations which clarified and provided specificity to these duties, as suggested above, its long standing approach of leaving such matters to state and federal courts will be very effective in dealing with these concerns. While the problems which have occurred in addressing these issues in recent years have gotten much attention, they have been considerably few in light of the number of credit unions in the country and have largely resulted from the lack of any guidance or specificity with regard to such issues.

Thank you for the opportunity to comment on this proposed rule making. With kindest regards, I remain,

Very truly yours,

Christopher J. Pippett

CJP/sjs